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THE DISABLED VETERANS TAX IMPACTS THOUSANDS OF VETERANS IN NEW MEXICO

PREPARED FOR REP. TOM UDALL

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EXECUTIVE SUMMARY

Every year, hundreds of thousands of disabled military veterans pay a “Disabled Veterans Tax” that effectively forces them to give up their disability benefits from the Department of Veterans Affairs. At the request of Rep. Udall, this report analyzes the impact of this regressive tax on veterans in New Mexico.

Under current law, veterans with 20 years of military service are entitled to receive retirement benefits from the Department of Defense. In addition, veterans who incurred service-related disabilities are entitled to receive disability compensation benefits from the Department of Veterans Affairs. If a veteran has both 20 years of military service and a service-related disability, however, the veteran’s military retirement benefit is reduced on a dollar-for-dollar basis by the amount the veteran receives in disability compensation. This reduction in the veteran’s retirement benefits is commonly known as the “Disabled Veterans Tax.” Effectively, the disability compensation received by these veterans is taxed at a 100% rate.

This report contains the first analysis of the effect of the Disabled Veterans Tax in New Mexico. The analysis finds that the Disabled Veterans Tax has a significant impact on veterans in the state. Specifically, it finds that:

- **Thousands of veterans in New Mexico are subject to the Disabled Veterans Tax.** Almost 6,800 veterans in New Mexico lose military retirement benefits due to the Disabled Veterans Tax. An estimated one out of every three retired veterans in the state (33%) is subject to the Disabled Veterans Tax.
- **The Disabled Veterans Tax costs veterans in New Mexico millions of dollars annually.** Statewide, veterans subject to the Disabled Veterans Tax lose over \$39 million in benefits annually. This is an average of approximately \$5,850 per affected veteran in the state. For these veterans, this amounts to an estimated reduction in military benefits of 24%.
- **Legislation to end the Disabled Veterans Tax would help veterans in New Mexico.** Rep. Udall has cosponsored H.R. 303, the Retired Pay Restoration Act of 2003. Passage of this bill would end the Disabled Veterans Tax for any veteran with over 20 years of military service, restoring full benefits to veterans in New Mexico.

THE DISABLED VETERANS TAX

Disabled military retirees receive benefits through two agencies, the Department of Defense and the Department of Veterans Affairs.

Veterans who have served for at least 20 years in the military receive standard retirement benefits from the Department of Defense. These benefits are determined by multiplying 2.5% of the service member's final basic pay by the number of years of service. Thus, a service member who has served for 20 years would receive annual retirement benefits equal to 50% of their final basic pay. Presently, there are an estimated 1.4 million retired veterans who receive average retirement pay of \$22,000 annually.¹

Veterans who have service-related disabilities also receive compensation through the VA. The goal of these payments is to compensate the veterans for the reduction in earnings capacity resulting from disabilities incurred during military service.² These payments are based on a scale of disability severity. This scale ranges from 10% disabled to 100% disabled. Average monthly disability payments in 2002 ranged from approximately \$100 for a veteran with a 10% disability to \$2,100 for a veteran who was 100% disabled.³

There are presently an estimated 560,000 retired service members who qualify for military retirement benefits and VA disability benefits. An 1891 law, however, bars "concurrent receipt" of both military retirement benefits and disability benefits. As a result, for veterans who receive both military retirement benefits from DOD and disability benefits from the VA, military retirement benefits are reduced dollar-for-dollar for each dollar of VA disability benefits.⁴

¹ Congressional Research Service, *Military Retirement: Major Legislative Issues* (July 10, 2003). In addition, retirees with less than 20 years service can also receive disability retirement benefits if they have either (1) completed at least 8 years of creditable military service and received a physical disability rating of 30% or greater from an evaluation board or (2) incurred a disability resulting from active duty. There are an estimated 100,000 of these service members currently receiving disability retirement.

² GAO, *Military and Veterans Benefits: Observations on the Concurrent Receipt of Military Retirement and VA Disability Compensation* (Mar. 2003) (GAO-03-575T). Additional benefits are paid to veterans who are at least 30% disabled and have dependents and to very severely disabled veterans who qualify for "special monthly compensation."

³ *Id.*

⁴ Disabled retirees can choose to have either their military retirement benefits reduced by the amount of their VA compensation, or their VA compensation reduced by the amount of their retirement benefit. Because military retirement benefits are taxable, while VA compensation is not, the vast majority of retirees choose to reduce their military compensation.

The result of this policy — known as “the Disabled Veterans Tax” — is that hundreds of thousands of disabled veterans are denied billions of dollars in benefits each year. According to data from the Department of Defense, an estimated 565,000 veterans lose over \$3 billion in benefits annually due to the Disabled Veterans Tax.

LEGISLATIVE EFFORTS TO ELIMINATE THE DISABLED VETERANS TAX

Periodically, Congress has made efforts to end the restrictions on concurrent receipt of military retiree and VA disability benefits. Most recently, in the 107th Congress in 2002, both the House and the Senate passed legislation to restore benefits to many veterans.⁵

Ultimately, neither the House nor the Senate proposals were enacted into law. The Bush Administration threatened to veto the entire DOD authorization legislation if either proposal was included in the final legislation. As a result, the final version of the legislation provided for “special pay” not subject to the offset only for veterans who suffered an injury for which they received a Purple Heart or who had a severe disability rated at 60% or more resulting from armed conflict, hazardous service, training activities that simulate war, or war-related circumstances.⁶ This law requires DOD to make a complicated calculation concerning each disability of each disabled retiree to determine which disabilities are combat related and therefore qualify for the special pay.

The final legislation was so narrowly crafted that it allows only an estimated 33,000 veterans to receive both military retirement and disability benefits.⁷ And it is so complicated that it may take years for retirees to prove their entitlement to special pay. For example, in cases involving a disability resulting from a retiree’s collision with an armored tank, payment of special compensation will depend upon whether the tank hit the retiree or the retiree hit the tank.⁸

⁵ The House legislation would have allowed veterans with disability ratings of 60% or greater to receive both military retirement benefits and VA disability benefits. This legislation would have restored benefits to an estimated 111,000 veterans. The Senate legislation would have allowed all disabled veterans to receive both military retirement pay and VA disability benefits. See Congressional Research Service, *Concurrent Receipt of Military Retirement and VA Disability Benefits: Budgetary Issues* (Nov. 15, 2002).

⁶ H.R. 4546, *FY 2003 DOD Authorization Act* (Nov. 2002).

⁷ CRS, *supra* note 5.

⁸ Department of Defense, *Combat-Related Special Compensation (CRSC) Web Site* (2003) (online at <https://www.dmdc.osd.mil/crsc/>).

The Disabled Veterans Tax Impacts Thousands of Veterans in New Mexico

Frustrated by Congress' repeated failures to repeal the Disabled Veterans Tax, Rep. Udall and other members of the House of Representatives launched a renewed legislative effort to end the tax in the 108th Congress. The goal of this effort is to enact legislation cosponsored by Rep. Udall: the Retired Pay Restoration Act of 2003 (H.R. 303). This legislation would eliminate the prohibition on concurrent receipt of veterans' retirements and disability benefits for all military retirees with at least 20 years of service. H.R. 303 currently has 352 cosponsors in the House.

Republican leaders in Congress oppose H.R. 303 and have not allowed a vote on the bill despite its broad support.⁹ In response, Rep. Jim Marshall (D-GA) filed a "discharge petition" on June 12, 2003, that would force House leaders to allow a vote on the bill.¹⁰ If the discharge petition receives the signatures of 218 House members (a majority of the House), House rules require a vote on the legislation. There are presently 200 Democratic members, one Republican member, and one independent member of the House who have signed the discharge petition. Rep. Udall has signed the discharge petition.

OBJECTIVE AND METHODOLOGY

This report was requested by Rep. Tom Udall, who represents the 3rd Congressional District of New Mexico. The district includes all of northern New Mexico, including the cities of Santa Fe, Rio Rancho, Farmington, Clovis, and Gallup. Rep. Udall requested this report in order to determine (1) the impact of the Disabled Veterans Tax on veterans in New Mexico and (2) the potential benefits for veterans in the state from enactment of H.R. 303.

To conduct this analysis, the Special Investigations Division obtained and analyzed data from the Office of the Actuary of the Department of Defense. The data includes zip code-level data on the total number of military retirees who are forced to pay the Disabled Veterans Tax. It also includes data on the monthly cost of the tax. Using this database, the Special Investigations Division summarized the impact of the Disabled Veterans Tax statewide and in each of New Mexico's congressional districts.¹¹

⁹ House Speaker Dennis Hastert, *Transcript of Press Conference* (June 26, 2003) (online at <http://releases.usnewswire.com/GetRelease.asp?id=137-06272003>).

¹⁰ Discharge Petition 108-002.

¹¹ All data in the DOD database was available at the 5-digit zip code level. Because 5-digit zip codes can sometimes be split between two or more congressional districts, the analysis assumes that when a zip code is split between two districts, half of the impacted veterans in the zip code are in each congressional district. Similarly, when a zip code is split between three districts, one-third of the impacted veterans in the zip code are assumed to be in each congressional district.

FINDINGS

The Disabled Veterans Tax Affects Thousands of Veterans in New Mexico

There are 20,366 veterans in New Mexico who receive military retirement benefits. Of these veterans, 6,751 veterans — 33% — also receive disability benefits from the VA and are subject to the Disabled Veterans Tax.

The Disabled Veterans Tax Costs Veterans in New Mexico Millions of Dollars Annually

Statewide, the Disabled Veterans Tax costs veterans \$3.3 million each month in lost disability benefits. This is equivalent to \$39.5 million annually.

On a per-veteran basis, the Disabled Veterans Tax costs each of the 6,751 impacted veterans in New Mexico an average of \$5,852 annually.

The average retired veteran in New Mexico receives retirement benefits of approximately \$18,600 annually. The Disabled Veterans Tax reduces benefits for affected veterans in the state by an estimated 24%.

Appendix 1 contains information on the effect of the Disabled Veterans Tax in each of the congressional districts in New Mexico.

Legislation To Eliminate the Disabled Veterans Tax Would Have Significant Benefits in New Mexico

Legislation cosponsored by Rep. Udall, the Retired Pay Restoration Act of 2003 (H.R. 303), would eliminate the Disabled Veterans Tax for all retired veterans with at least 20 years of service. Passage of H.R. 303 would result in increased benefits for 6,751 veterans in New Mexico. These veterans would receive an increase in benefits of over \$39 million annually.

CONCLUSION

An 1891 law prevents disabled veterans from receiving both military retirement and VA service-connected disability compensation. As a result, hundreds of thousands of military veterans are forced to pay the Disabled Veterans Tax, effectively reducing their benefits by billions of dollars each year. This analysis finds that 6,751 disabled veterans in New Mexico are forced to pay the Disabled Veterans Tax. Legislation cosponsored by Rep. Udall would eliminate the Disabled Veterans Tax for these veterans.

The Disabled Veterans Tax Impacts Thousands of Veterans in New Mexico

**Appendix 1: Impact of the Disabled Veterans Tax by
Congressional District in New Mexico**

District Number	Representative	Number of Veterans in District Who Lose Benefits to the Disabled Veterans Tax	Total Annual Lost Benefits	Average Lost Benefits Per Veteran	% of All Retired Veterans in District Who Lose Benefits to the Disabled Veterans Tax
NM-1	Heather Wilson	2,772	\$16,014,996	\$5,777	31%
NM-2	Stevan Pearce	2,372	\$14,126,232	\$5,955	33%
NM-3	Tom Udall	1,598	\$9,330,852	\$5,841	37%